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Accounting for catastrophe reserves

United States. Securities and Exchange Commission

For RELEASE Wednesday, January 3, 1973

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

SECURITIES ACT OF 1933
Release No. 5345

SECURITIES EXCHANGE ACT OF 1934
Release No. 9923

ACCOUNTING SERIES
Release No. 134

Accounting for Catastrophe Reserves

In the past two years a number of companies in the property and casualty insurance field have adopted the accounting policy of making a provision from each period's income to cover a portion of major losses expected to occur in future periods. The reserves provided, generally called catastrophe reserves, have been justified by the companies on the grounds that periodic premiums include an amount to cover such losses which occur irregularly and the process of matching revenue and expense therefor requires accrual of a provision for such losses.

The Committee on Insurance Accounting and Auditing of the American Institute of Certified Public Accountants and the Accounting Principles Board have discussed this accounting policy but have not yet come to a decision as to desirability of this accounting either in general or under particular circumstances. The Insurance Committee is currently working actively on the subject in cooperation with industry groups and expects to have a definitive statement in ample time to permit its application in the 1973 annual accounts of affected insurance companies.

The Commission believes that it is undesirable to have alternative accounting principles for the description of the same factual situation and it encourages the efforts of the AICPA and the industry to define appropriate accounting in this area. It has taken no position on the relative desirability of the alternative accounting principles now being used.

In the meantime, however, investors have been and are confronted with financial statements for companies in the same industry which reflect different accounting applications due to an accounting principles recently adopted by some of the companies. Under such circumstances, full disclosure appears to be the best interim solution so that investors will be able to perceive the existence of alternative principles and their impact on the financial statements. Accordingly, in financial statements prepared (by companies in the industry) prior to the development of a definitive statement as to appropriate accounting for catastrophe losses, disclosure should be made which includes the following items:

1. A statement whether or not the company is providing a reserve for catastrophe losses.

2. Disclosure that the Committee on Insurance Accounting and Auditing of the AICPA in cooperation with industry representatives is considering the catastrophe reserve problem and that prompt resolution is likely which could lead to changes in accounting practices being followed.

3. If the company does provide for "catastrophe losses," disclosure of the dollar impact of this accounting practice on the balance sheets and income statements of the years reported or a statement that the impact is immaterial.

By the Commission.

Ronald F. Hunt
Secretary